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Business Outlook Survey

Conducted by the Bank's Regional Offices

Results of the Autumn 2010 Survey Vol. 7.3 8 October 2010

Overview

- Responses to the autumn survey suggest that the economic recovery is progressing. Firms remain positive about the outlook over the next 12 months, but they generally expect growth to be modest, owing in part to a weaker outlook for the U.S. economy.
- Supported by the recovery to date and recognizing the challenges that lie ahead, firms are increasingly focusing on ways to enhance productivity and create new growth opportunities. The balance of opinion on investment reached a new high, while employment intentions have eased but remain positive.
- Indicators of pressures on production capacity are above the levels recorded during the recession, although they remain below average for the survey. While the balance of opinion on output prices remains elevated, many firms cite plans to keep prices stable or to raise them slightly, following a period during which prices were falling or frozen. Inflation expectations have eased but remain well anchored.
- On balance, firms reported that credit conditions eased over the past three months.

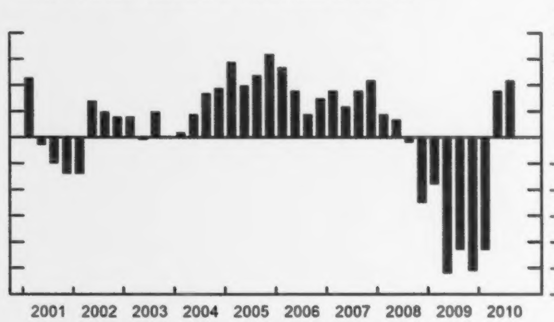
Business Activity

On balance, firms reported an increase in sales growth over the past 12 months **(Chart 1)** and continue to expect an improvement over the next 12 months **(Chart 2)**. Those expecting a pickup in sales growth are concentrated in the

Chart 1: Firms report a pickup in sales growth over the past year . . .

Balance of opinion*

Over the past 12 months, did your firm's sales volume increase at a greater, lesser, or the same rate as over the previous 12 months?



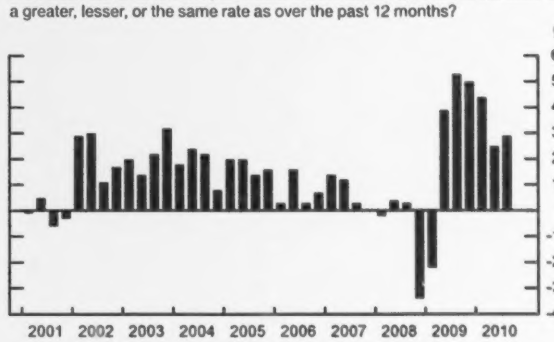
Greater: 55% Same: 13% Lesser: 33%

* Percentage of firms reporting faster growth minus percentage reporting slower growth

Chart 2: . . . and they expect sales volumes to rise at a greater rate over the next 12 months

Balance of opinion*

Over the next 12 months, is your firm's sales volume expected to increase at a greater, lesser, or the same rate as over the past 12 months?



Greater: 55% Same: 20% Lesser: 26%

* Percentage of firms expecting faster growth minus percentage expecting slower growth

The Business Outlook Survey summarizes interviews conducted by the Bank's regional offices with the senior management of about 100 firms selected in accordance with the composition of Canada's gross domestic product. The survey's purpose is to gather the perspectives of these businesses on topics of interest to the Bank of Canada (such as demand and capacity pressures) and their forward-looking views on economic activity. Additional information on the survey and its content is available on the Bank of Canada's website at <www.bankofcanada.ca/en/bos/index.html>. The autumn 2010 survey was conducted from 16 August to 16 September 2010. The balance of opinion can vary between +100 and -100. Percentages may not add to 100 because of rounding.

The opinions expressed are those of the respondents and do not necessarily reflect the views or policies of the Bank of Canada. The method of sample selection ensures a good cross-section of opinion. Nevertheless, the statistical reliability of the survey is limited, given the small sample size.

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goods sector, and are mainly firms that still await a recovery in sales or that experienced only a modest improvement over the past 12 months. Global uncertainties remain, although concerns have shifted from Europe back to the U.S. economy. A weaker outlook for U.S. economic growth is dampening sales expectations in a number of cases and reinforcing the general view that growth is likely to be moderate. With this context in mind, firms are taking measures to reposition themselves for growth.

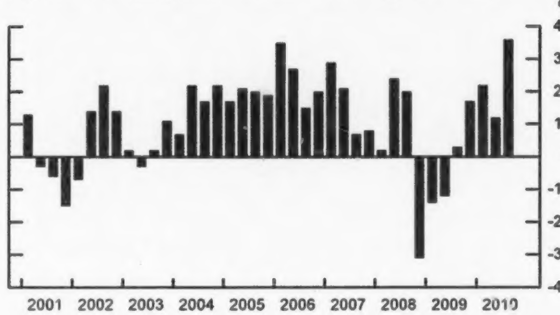
The balance of opinion on investment in machinery and equipment rose to a new high in the autumn survey **(Chart 3)**, pointing to an increase in investment over the next 12 months. The increase in this indicator is widespread across all regions and sectors. Following a period of restraint in investment expenditures, many firms reported plans to resume more normal levels of spending, with an increasing focus on enhancing productivity or expanding into new and more profitable business lines.

The balance of opinion on employment declined but remains positive, indicating that firms intend to increase employment over the next 12 months **(Chart 4)**. The balance is positive across sectors and regions, supported in part by plans for expansion. However, the balance of opinion has declined from the levels seen earlier in the recovery. Some firms had recently increased employment to a level sufficient to meet expected demand, while others were focusing on achieving productivity gains from new equipment or new processes.

Chart 3: Firms expect to increase investment in machinery and equipment

Balance of opinion*

Over the next 12 months, is your firm's investment spending on M&E expected to be higher, lower, or the same as over the past 12 months?



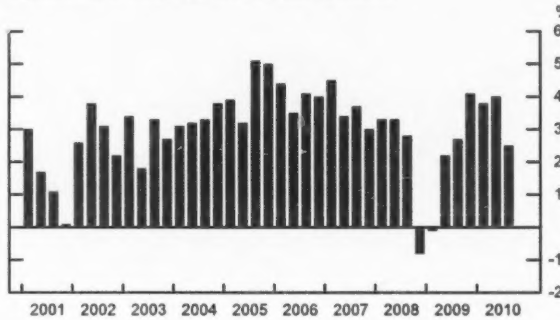
Higher: 46% Same: 44% Lower: 10% No response: 1%

* Percentage of firms expecting greater investment minus the percentage expecting less investment

Chart 4: Firms expect to increase employment

Balance of opinion*

Over the next 12 months, is your firm's level of employment expected to be higher, lower, or the same as over the past 12 months?



Higher: 39% Same: 48% Lower: 14%

* Percentage of firms expecting higher levels of employment minus the percentage expecting lower levels

Pressures on Production Capacity

Responses to the question regarding the ability to meet demand suggest little change in capacity pressures from the summer survey. While the overall number of firms reporting that they would have difficulty meeting an unexpected increase in demand edged down slightly, the number reporting significant difficulty has risen **(Chart 5)**. Reports of capacity constraints are somewhat higher among firms in the goods-producing sector.

Chart 5: Capacity pressures are little changed . . .

How would you rate the current ability of your firm to meet an unexpected increase in demand?

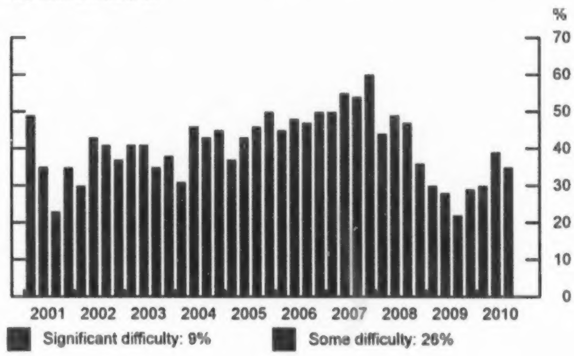
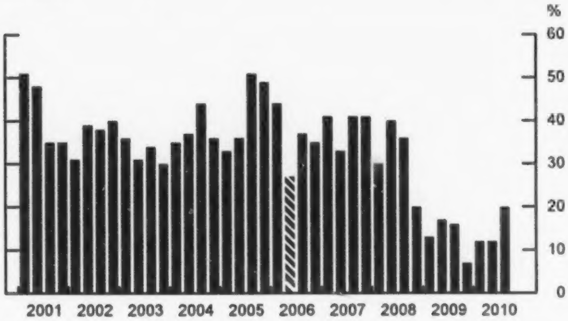


Chart 6: . . . and reports of labour shortages have moved up but remain relatively low

Does your firm face any shortages of labour that restrict your ability to meet demand?



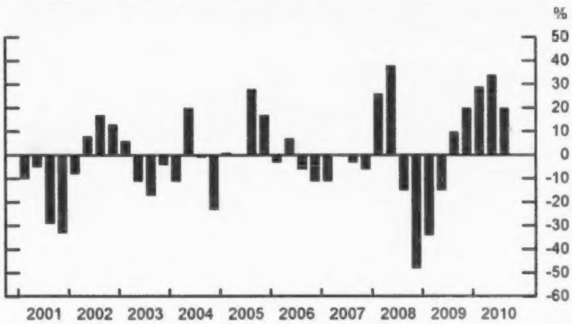
Yes: 20%

The summer 2006 results are not strictly comparable with those of the other surveys, owing to a difference in the interview process for that survey.

Chart 7: Firms expect input prices to increase at a greater rate . . .

Balance of opinion*

Over the next 12 months, are prices of products/services purchased expected to increase at a greater, lesser, or the same rate as over the past 12 months?



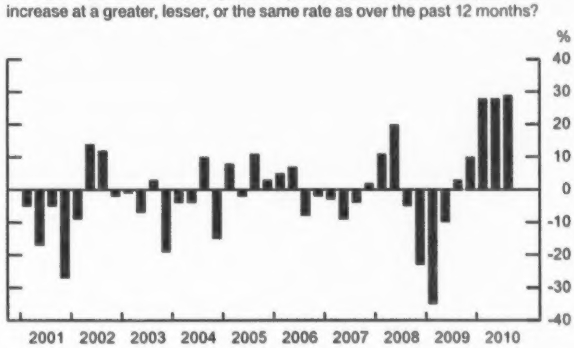
Greater: 43% Same: 34% Lesser: 23% No response: 1%

* Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

Chart 8: . . . and output prices to increase at a greater rate as well

Balance of opinion*

Over the next 12 months, are prices of products/services sold expected to increase at a greater, lesser, or the same rate as over the past 12 months?



Greater: 45% Same: 39% Lesser: 16% No response: 1%

* Percentage of firms expecting greater price increases minus the percentage expecting lesser price increases

The number of firms reporting that labour shortages are restricting their ability to meet demand moved up in the autumn survey **(Chart 6)**. Firms reporting labour shortages often cited a lack of workers with highly specialized knowledge or regional pockets where labour is in short supply.

Overall, both indicators of pressures on production capacity have risen above the levels recorded during the recession but remain below their average levels for the survey, notably in the case of labour shortages.

Prices and Inflation

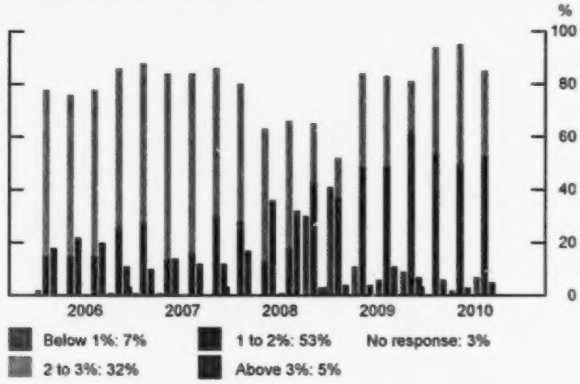
On balance, businesses expect input prices to rise by more than they did over the past 12 months **(Chart 7)**. The balance of opinion has eased from its level in the previous two surveys, however, as some firms that have seen a pickup in input costs now expect price increases to slow over the next 12 months.

The balance of opinion on output prices is unchanged at a high level **(Chart 8)**, indicating that firms expect output prices to rise at a greater rate over the next 12 months. The balance of opinion continues to reflect, in part, intentions to keep prices stable or to raise them slightly over the next 12 months, following a period of falling or frozen prices. Although some firms cited plans to pass through higher input costs, several mentioned that competitive pressures and modest demand are expected to limit the magnitude of any price increases.

Expectations regarding total CPI inflation over the next two years have eased, although the large majority of firms continue to expect inflation to be within the Bank's inflation-control range of 1 to 3 per cent **(Chart 9)**.

Chart 9: Inflation expectations remain anchored within the Bank's inflation-control range

Over the next two years, what do you expect the annual rate of inflation to be, based on the consumer price index?



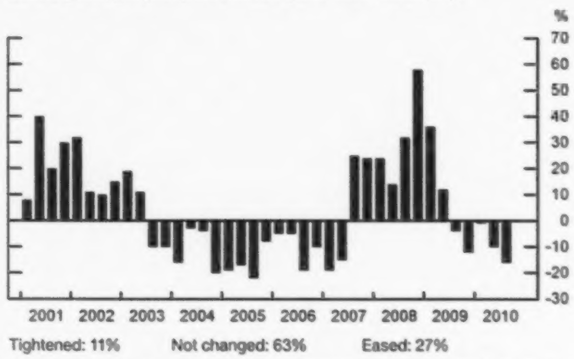
Credit Conditions

The balance of opinion on credit conditions is negative **(Chart 10)**, suggesting that credit conditions eased over the past three months. While still driven by large firms and those with access to domestic capital markets, the results indicate that improvements in credit conditions are starting to become more broadly based. Nevertheless, small businesses continued to report little change in their access to credit.

Chart 10: Credit conditions eased over the past three months

Balance of opinion*

Over the past three months, how have the terms and conditions for obtaining financing changed (compared with the previous three months)?



* Percentage of firms reporting tightened minus percentage reporting eased. For this question, the balance of opinion excludes firms that responded "not applicable."

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